Supreme Court of the United States

OCTOBER TERM, 1936

IN THE MATTER OF UNITED CIGAR STORES COMPANY OF AMERICA, Debtor.	
CITY BANK FARMERS TRUST COMPANY, assignee of Florence H. Bugbee, Petitioner, AGAINST IRVING TRUST COMPANY, as Trustee of the Estate of the above-named Debtor, *et al.*, Respondents.	No. 260.

MOTION FOR LEAVE TO FILE BRIEF AS AMICI CURIAE

MAY IT PLEASE THE COURT:

The undersigned, with the consent in writing of all the parties, respectfully move for leave to file the accompanying brief as *Amici Curiæ* on behalf of Ella May Voight, Dorothy Voight, and Edward B. Lucius, as Trustees of the William F. Voight Trust, upon the application of the above Petitioner for a writ of certiorari to the United States Court of Appeals for the Second Circuit.

JOHN GERDES,
JOHN GODFREY SAXE,
Amici Curiæ.

BRIEF OF JOHN GERDES AND JOHN GODFREY SAXE, AS AMICI CURIAE

Preliminary Statement

The *Amici Curiæ* are the attorneys for Ella May Voight, Dorothy Voight and Edward B. Lucius, as Trustees of the William F. Voight Trust. The Voight Trust has a claim against the estate of the Debtor in the sum of over $200,000. The provability of this claim depends upon the question of law which is involved in this case.

All further references to facts in this brief will be to the facts of the claim of Petitioner herein and not to the facts of the claim of said Voight Trust.

The Question

This case presents the question whether in proceedings under Section 77B of the Bankruptcy Act a landlord may prove a claim for injury resulting from the rejection of his lease by the trustee in the bankruptcy proceeding in which the 77B petition was filed, where the lease contained no covenant for damages or indemnity and the applicable state law gave no claim for damages for breach of a covenant to pay rent, and where the landlord terminated the lease by reentry after the rejection and prior to the enactment of Section 77B.

If such a claim is provable, the judgment below is erroneous regardless of the correctness of the decision on the question of New Jersey law also involved in the case.

The Statute

"A plan of reorganization . . . (6) may reject contracts which are executory in whole or in part, including

unexpired leases . . ." Bankruptcy Act § 77B (b)(6), 11 U. S. C. A. § 207 (b)(6).

"The term 'creditors' shall include for all purposes of this section and of the reorganization plan, its acceptance and confirmation, all holders of claims of whatever character against the debtor or its property, including claims under executory contracts whether or not such claims would otherwise constitute provable claims under this Act.. * * *

"In case an executory contract or unexpired lease of real estate shall be rejected pursuant to direction of the judge given in a proceeding instituted under this section, or shall have been rejected by a trustee or receiver in bankruptcy or receiver in equity, in a proceeding pending prior to the institution of a proceeding under this section any person injured by such rejection shall, for all purposes of this section and of the reorganization plan, its acceptance and confirmation, be deemed to be a creditor. The claim of a landlord for injury resulting from the rejection of an unexpired lease of real estate or for damages or indemnity under a covenant contained in such lease shall be treated as a claim ranking on a parity with debts which would be provable under section 63 (a) of this Act, but shall be limited to an amount not to exceed the rent, without acceleration, reserved by said lease for the three years next succeeding the date of surrender of the premises to the landlord or the date of reentry of the landlord, whichever first occurs, whether before or after the filing of the petition, plus unpaid rent accrued up to such date of surrender or reentry: Provided, That the court shall scrutinize the circumstances of an assignment of future rent claims and the amount of the consideration paid for such assignment in determining the amount of damages allowed assignee hereunder" Bankruptcy Act § 77B (b)(10), 11 U. S. C. A. § 207 (b)(10).

". . . the judge, . . . (5) may direct the rejection of contracts of the debtor executory in whole or in part; . . ." Bankruptcy Act § 77B (c)(5), 11 U. S. C. A. § 207 (c)(5).

Opinion of the Circuit Court of Appeals

The opinion of the Circuit Court of Appeals in this case is reported in *In re United Cigar Stores Co. of America (City Bank Farmers Trust Co.)*, 83 F. (2d) 209. A more complete statement of the Circuit Court's views on the question involved herein is found in *In re United Cigar Stores Co. of America (Otis)*, 83 F. (2d) 202, at 206, and in *In re United Cigar Stores Co. of America (Kuhner-Fischer)*, C. C. A., Second Circuit, July 14, 1936, not yet reported.

The Circuit Court of Appeals held that a claim is not provable in proceedings under Section 77B for the injury resulting from the rejection of a lease in a prior bankruptcy proceeding unless, at the inception of the 77B proceedings, the landlord had a claim under applicable state law or under a covenant for damages or indemnity in the lease; and that there is no provable claim if the lease was terminated after the rejection without the survival of a claim under applicable state law or under a covenant for damages or indemnity.

The position of the Circuit Court is summarized in the following statement from its opinion in the *Kuhner-Fischer* case, *supra:* "we cannot suppose that Congress was trying to make over the contract by imposing a liability for future rent on the lessee after the term had ended. Indeed, we should have considerable doubt whether the bankruptcy power would support such an effort."

SUMMARY OF ARGUMENT

Point I

Section 77B eliminates the distinction between the provability of claims under leases and claims under other executory contracts.

Point II

The interpretation of the Court below makes the provision in Section 77B giving a claim for the rejection of a lease, meaningless and of no effect. Its decision on the Kuhner-Fischer claim (In re United Cigar Stores Co. of America (Kuhner-Fischer), C. C. A. Second Circuit, July 14, 1936, not yet reported) is contradictory to its decision in the case at bar.

Point III

The language of Section 77B is similar to that used in the English Bankruptcy Acts and should be given the same meaning.

Point IV

Surrender or reentry, after rejection of the lease, does not deprive the landlord of his claim. On the contrary, it is a condition precedent to proof of the injury resulting from such rejection.

Point V

Section 77B gives a provable claim where the lease was rejected and terminated prior to the enactment of Section 77B in a bankruptcy proceeding which is still pending when the proceedings under Section 77B are initiated.

Point VI

The grant of a provable claim for the injury caused by the rejection of a lease in a bankruptcy proceeding pending when Section 77B was enacted is not unconstitutional.

POINT I

Section 77B eliminates the distinction between the provability of claims under leases and claims under other executory contracts.

Prior to the amendment of Section 63(a) of the Bankruptcy Act and the enactment of Section 77B of the Bankruptcy Act, in June, 1934, the courts refused to give the same provable claim for the breach of an executory lease contract as was given for the breach of other executory contracts.

The injustices caused by this discrimination are well illustrated in the case at bar. The landlord had a contract of lease under which she was entitled to substantial sums of money for the use of her property for a period which was not to terminate until 1946. The lessee was adjudicated bankrupt. Until the intervention of bankruptcy the lease remained in full force and effect and neither party had violated any of its covenants. After the adjudication in bankruptcy the terms of the lease were not performed by the bankrupt, nor were they assumed or performed by its receiver or trustee in bankruptcy.

Creditors having claims for injury resulting from the rejection of executory contracts other than leases were given the right to participate, for the injury resulting from the abrogation of their contracts, in the division of the bankrupt's assets. This landlord, injured by the rejection of her executory lease contract, had no provable claim. It is true that she could have kept the lease alive, in spite of the fact that it was not being performed, and could have held the bankrupt (shorn of all its assets) for the performance of the lease; but this was a "paper" right which had no value, since the bankrupt had been deprived of all power to perform the lease.

If Section 77B does not grant provable claims to landlords for leases rejected in proceedings under the Section,

greater injustices will result than formerly resulted in bankruptcy. Bankruptcy proceedings discharge only *provable* debts. Proceedings under Section 77B discharge all debts and liabilities, regardless of their provability. Bankruptcy Act § 77B(g), (h).

Except for the limitation on the amount for which a rent claim may be proved, the provisions in Section 77B regarding executory contracts and unexpired leases are identical. See clause (6) and text following clause (10) of subdivision (b), and clause (5) of subdivision (c).

The *Amici Curiæ* respectfullly urge that Section 77B eliminates the distinction between the provability of claims under leases and claims under other executory contracts, and makes the doctrine of *Central Trust Co.* v. *Chicago Auditorium*, 240 U. S. 581, applicable to leases of real estate.

Under Section 77B, as under the doctrine of the foregoing case, the claim is given for the injury resulting from the rejection of the contract or lease (failure to adopt or assume it) by the receiver or trustee of the estate in liquidation or reorganization. It is given for the breach of an "implied term of every contract that the promisor will not permit himself, through insolvency or acts of bankruptcy, to be disabled from making performance . . ." (240 U. S. 581, 591).

The rejection is not a *breach* of the contract or lease. The breach antedates the "rejection" (failure of the receiver or trustee to assume), and occurs when the lessee or contractor permits itself to be deprived of the power of performing its obligations by surrender of all its assets to the bankruptcy court and its receiver or trustee. This breach occurs upon the initiation of the proceedings and not when the receiver or trustee fails to assume or adopt the contract or lease.

After his appointment, the receiver or trustee has a reasonable period of time within which to adopt or assume

the contract or lease. If he assumes or adopts within such period, the court, as a court of equity, will not (in the absence of an express covenant) permit a forfeiture of the contract or lease because of the prior breach.

The receiver or trustee is under no obligation to assume or adopt the contract or lease. His failure to do so ("rejection") is therefore not a breach.

Except for a limitation in the total amount which may be proved, Section 77B measures the claim for a rejection of a lease just as in the case of any other executory contract. In the absence of an express provision in the contract, it liquidates the claim by discounting future rent payments due under the contract and subtracting the appraised value of the use of the premises for the balance of the term. If the lease has a covenant for damages or indemnity—if the parties have expressly agreed upon the measure of the claim—and the measure is not too speculative to admit of reasonable proof and is not in the nature of a penalty—the claim is measured by the terms of the covenant for damages or indemnity. If the covenant for damages or indemnity is in the nature of a penalty or is too speculative to admit of reasonable proof, the covenant must be disregarded and the claim measured as though the lease contained no covenant for damages or indemnity.

Until the landlord is given the right to possession of the premises by "surrender" by the receiver or trustee, or until the landlord takes possession through "reentry", he is entitled to all accrued and unpaid rent; thereafter (since he has possession of the premises or may take such possession) he is entitled to prove a claim only for the difference between the reasonable value of the use of the premises and the rent reserved in the lease, limited however to a sum amounting to not more than three years of rent.

Complete and equitable relief is thus given to landlord and tenant. The tenant is relieved of future obligations under the lease. The landlord is given a provable claim against the estate of his lessee.

POINT II

The interpretation of the court below makes the provision in Section 77B giving a claim for the rejection of a lease, meaningless and of no effect. Its decision on the Kuhner-Fischer claim is contradictory to its decision in the case at bar. (In re United Cigar Stores Co. of America (Kuhner-Fischer), C. C. A. Second Circuit, July 14, 1936, not yet reported).

The theory of the Circuit Court of Appeals, that no claim is provable unless the lessor has a claim under applicable state law or under a covenant for damages or indemnity when the 77B proceedings are initiated, ignores the fundamental basis of the claim given to the landlord by Section 77B. It erroneously fails to base the claim upon a *rejection* of the lease, or even upon the lease itself; it bases the claim upon a debt created by a prior breach of the lease, or upon a new contract for damages or indemnity arising upon the termination of the lease (*Manhattan Properties* v. *Irving Trust Co.*, 291 U. S. 320, 338).

If this erroneous theory is applied, the grant of a claim when the lease "shall have been rejected by a trustee . . . in bankruptcy . . . in a proceeding under this section" [Bankruptcy Act § 77B (b) (10)] is redundant and wholly without meaning, for it is obvious that even without such provision all debts and contract claims which are valid and enforcible against the debtor when the petition under Section 77B is filed are provable in the proceedings.

The language of Section 77B which gives a claim for the injury sustained by a lease rejection is unnecessary and useless if its only effect is "to make some valid claims provable in proceedings under Section 77B which were not before provable in bankruptcy" (Opinion below, in this case, 83 F. (2d) 209, 211). Section 77B elsewhere

makes existing claims "provable" regardless of whether they would have been provable in ordinary bankruptcy proceedings. Subdivision (b) (10) provides that the term "creditors" shall include "holders of claims of whatever character against the debtor or its property, including claims under executory contracts, *whether or not such claims would otherwise constitute provable claims under this Act*" (Italics ours).

The Circuit Court of Appeals has recently rendered a decision which is inconsistent with its decision in the case at bar. In *In re United Cigar Stores Co. of America* (*Kuhner-Fischer*), C. C. A. Second Circuit, July 14, 1936, not yet reported, the Court allowed a claim under a covenant of indemnity although under the applicable state and federal decisions the claim is too speculative to be proved.

In the *Kuhner-Fischer* case, as in this case, the trustee in the prior bankruptcy proceeding rejected the lease. In each case the landlord reentered after such rejection. In the *Kuhner-Fischer* case the lease contained a covenant of indemnity under which it was agreed that if the lessee should be adjudicated a bankrupt the landlord might reenter and the lessee would then "indemnify the landlord against all loss of rent which the landlord may incur by reason of such termination during the residue of the term". In the case at bar the lease contained no such covenant. The Circuit Court of Appeals allowed the claim in the *Kuhner-Fischer* case but denied the claim in the case at bar.

In the *Kuhner-Fischer* case, the Court correctly held that an absolute liability of the lessee on the covenant of indemnity was created by the bankruptcy of the lessee and the reentry of the landlord, and that such liability still existed when the proceedings under Section 77B were initiated. However, instead of allowing a claim on the liability created by this covenant, the Court allowed the claim as for an injury resulting from the rejection of the lease in bankruptcy.

In the *Kuhner-Fischer* case the landlord had no "claim against a lessee for damages or indemnity under a covenant contained in a lease which would have been recoverable in a civil action had there been no 77B petition approved . . ." (*In re United Cigar Stores Co. of America (Otis)*, 83 F. (2d) 202, 206). The amount of the claim on the new contract of indemnity was too speculative to be proved or recovered under applicable state law until the end of the original term of the lease (*Hermitage Co.* v. *Levine,* 248 N. Y. 333).

In addition, the claim actually allowed was different from, and contradictory to, the claim given to the landlord by the express language of the covenant. Under the contract of indemnity, the claim was to be measured by the difference, at the end of the term of the lease, between the amounts of rent actually collected by the landlord during the term and the total rents to be paid under the lease. The Court permitted "the claim to be liquidated like a claim for breach of an executory contract for chattels; that is, by discounting the future payments and subtracting the appraised value of the term from their sum".

In spite of its statement that "we cannot suppose that Congress was trying to make over the contract", the Court actually *did* make over the contract of indemnity by allowing a claim which was not based on such contract of indemnity. As this Court stated in *Manhattan Properties* v. *Irving Trust,* 291 U. S. 320 at page 337:

> "These [indemnity covenants] do not provide for liquidation of damages (compare *Wm. Filene's Sons Co.* v. *Weed, supra*), nor indeed for any right to damages for breach of the covenant to pay rent."

The result reached by the Court in determining the Kuhner-Fischer claim was sound. The claim was properly liquidated "like a claim for breach of an executory contract for chattels". But this conclusion is warranted only

on the theory that Section 77B gives the same provable claim on an executory lease as on any other executory contract; that the damages resulting from the breach of the covenant of indemnity in the Kuhner-Fischer lease were too speculative to admit of reasonable proof; and that the claim was therefore measured as though the lease contained no covenant for damages or indemnity.

On this theory, petitioner in the case at bar was entitled to the allowance of its claim.

POINT III

The language of Section 77B is similar to that used in the English Bankruptcy Acts and should be given the same meaning.

The phrase "any person injured by such rejection" is "deemed to be a creditor" closely resembles the language employed by Section 23 of the English Bankruptcy Act of 1869 (32 and 33 Vict., c. 71). After providing for the "disclaimer" of leases, that Act stated:

> "Any person injured by the operation of this section shall be deemed a creditor of the bankrupt to the extent of such injury, and may accordingly prove the same as a debt under the bankruptcy."

Prior to the enactment of this provision, claims for the injury sustained by a landlord because of a rejection of his lease in bankruptcy proceedings, where the lease contained no covenant for damages or indemnity, were not provable. This language in the English Bankruptcy Act of 1869 served to make such claims provable.

> "In England such claims were not provable under the Act of 7 Geo. I, c. 31; *Mayor* v. *Steward,* 4 Burr. 2439; and a discharge could not be pleaded in defense of an action for rent accruing subsequent to bankruptcy. *Boot* v. *Wilson,* 8 East 311. The landlord's claim for loss of future rent was made provable by

the Act of 32 and 33 Vict., c. 71, § 23 (1869), and more explicit provisions to the same effect were embodied in that of 46 and 47 Vict., c. 52, §§ 37 and 55 (1883)."

Manhattan Properties v. Irving Trust Co., 291 U. S. 320, 332.

Substantially the same language as was used in the English Bankruptcy Act of 1869 was repeated in the English Bankruptcy Act of 1883 (46 and 47 Vict., c. 52, Sec. 55). Again, the similarity to Section 77B is apparent:

"(7) Any person injured by the operation of a disclaimer under this section shall be deemed to be a creditor of the bankrupt to the extent of the injury and may accordingly prove the same as a debt under the bankruptcy."

The law as fixed by the foregoing section has been stated by an English authority to be as follows:

"8. *Proof for injury done by the disclaimer.*—By sub-section (7) of Section 55 any person injured by the operation of a disclaimer is to be deemed a creditor of the bankrupt to the extent of the injury, and may accordingly prove the same as a debt under the bankruptcy. The measure of the damages, so far as the rent is concerned, will be the difference between the rent due under the lease for the residue of the term and the rent now to be obtained (Re Llynvi Coal Co., 7 Ch. 28), and it will include also the sum required to leave the property in the same state as if the covenants had been properly performed."

Disclaimer of Leasehold Property in Bankruptcy, 42 Solicitors' Journal 228, 230 (1898).

POINT IV

Surrender or reentry, after rejection of the lease, does not deprive the landlord of his claim. On the contrary, it is a condition precedent to proof of the injury resulting from such rejection.

Section 77B (b) provides that the claim of a landlord resulting from the rejection of an unexpired lease shall be: (1) for all "unpaid rent accrued up to such *date of surrender or reentry*"; plus (2) "an amount not to exceed the rent, without acceleration, reserved by said lease for the three years next succeeding the *date of surrender* of the premises to the landlord or the *date of reentry* of the landlord, whichever first occurs * * *." (Italics ours.)

It is evident, therefore, that no claim is provable until after there has been either a "surrender of the premises to the landlord" or a "reentry of the landlord".

Surrender or reentry by the landlord not only does not take away the claim given by Section 77B, but it is a condition precedent to the provability of such a claim, for without a surrender or reentry there is no prescribed method for fixing the amount of the claim.

Even aside from the express provision in Section 77B, it is obvious that the landlord's claim may reasonably be measured only if the lease is terminated. An obligation to pay rent remains against the tenant so long as the lease is alive. While this liability exists, the amount of the damage which the landlord will sustain will be contingent upon the extent to which rent is paid in the future by the tenant or his assignee. If this possibility of performance is not eliminated, the damage which the landlord will sustain will be too speculative to permit of reasonable ascertainment.

One of the reasons given by the Courts for not allowing rent claims in bankruptcy proceedings, prior to the amend-

ment of Section 63 a of the Bankruptcy Act in 1934, was "because of the uncertainty at the date of adjudication that the lessor will reenter" (*Manhattan Properties* v. *Irving Trust*, 291 U. S. 320, 331).

The original rent provision in the Bill which enacted Section 77B (H. R. 5884, 73rd Cong. 1st Sess.) declared that a claim under a rejected executory contract would be allowed "provided such contract shall not have been terminated by forfeiture, reentry or otherwise." The omission of this language in the Act as passed, must be taken as a clear indication of a change in the intent of Congress.

POINT V

Section 77B gives a provable claim where the lease was rejected and terminated prior to the enactment of Section 77B in a bankruptcy proceeding which is still pending when the proceedings under Section 77B are initiated.

The recent decision of the Circuit Court of Appeals in proceedings involving this Debtor (*In re United Cigar Stores Co. of America* (*Kuhner-Fischer*), C. C. A. Second Circuit, July 14, 1936, not yet reported), allowed a claim for the rejection of a lease in a prior bankruptcy proceeding where such rejection occurred and the lease was terminated prior to the enactment of Section 77B.

Section 77B (b) gives the landlord a claim for the resultant injury "in case an * * * unexpired lease of real estate * * * shall have been rejected by a trustee or receiver in *bankruptcy* * * * *in a proceeding pending prior to the institution of a proceeding under this section* * * *." It also provides that the limitation of the landlord's claim shall be measured from "the date of the surrender of the premises to the landlord or the

date of reentry of the landlord, * * * *whether before or after the filing of the petition* * * *"* (Italics ours.).

This language is so clear that no argument seems necessary to establish the intent of Congress to bestow upon the landlord a claim for injury caused by the rejection of his lease in a prior bankruptcy proceeding, even if the premises were surrendered to the landlord, or he reentered, "*before* * * * the filing of the petition * * *" initiating the proceedings under Section 77B (Italics ours).

Section 77B also provides:

> "(p) This section shall take effect and be in force from and after the date of the approval of this amendatory Act and *shall apply* as *fully to debtors*, their stockholders *and creditors, whose interests or debts have been acquired or incurred prior to such date*, as to debtors, their stockholders and creditors, whose interests or debts are acquired or incurred after such date. *Proceedings under this section may be taken in proceedings in bankruptcy which are pending on the effective date of this amendatory Act*" (Italics ours.).

A consideration of the conditions which existed at the time when Section 77B was enacted makes it manifest that Congress intended to give relief to landlords who had been unjustly deprived of their rights by the rejection of leases in bankruptcy proceedings prior to the enactment of Section 77B.

The Debtor and other chain store corporations with numerous executory leases had voluntarily instituted bankruptcy proceedings in 1932. Although bankruptcy proceedings are usually intended for liquidation rather than reorganization, and these corporations desired reorganization, they went into bankruptcy because it afforded them an opportunity to avoid more lease claims than in an equity receivership.

On August 29, 1932, the order adjudicating the Debtor a bankrupt was entered. Within less than three months all its burdensome leases had been rejected.

The use of bankruptcy proceedings merely to cut off the claims of landlords was generally criticized, and almost became a national scandal. The facts were well known to the members of Congress. It was natural therefore for Congress to provide in Section 77B that a corporation desiring to discontinue pending bankruptcy proceedings and avail itself of the benefits of reorganization under Section 77B, could do so only if it granted the landlord a provable claim for the injury which he had previously sustained by the rejection of his lease in bankruptcy.

Section 77B was enacted on June 7, 1934. Within two days the Debtor voluntarily filed its petition under the Section.

That the provision in Section 77B relating to a rejection of an unexpired lease in a prior proceeding was included with specific reference to rejections which had occurred prior to the enactment of Section 77B becomes further apparent when it is realized that in the future the spectacle of a corporation first being subjected to bankruptcy proceedings and then having its administration transferred to proceedings under Section 77B is bound to be rare. The more likely procedure will be to attempt rehabilitation of the corporation under Section 77B first and to resort to liquidation only when the futility of reorganization becomes evident. It seems therefore that corporations in bankruptcy when Section 77B was enacted were the particular debtors against whom these rent provisions were directed.

POINT VI

The grant of a provable claim for the injury caused by the rejection of a lease in a bankruptcy proceeding pending when Section 77B was enacted is not unconstitutional.

This Court has already stated that Congress may grant a provable claim for future rents under a lease which has no covenant for damages or indemnity.

> "The issue is not one of power, for plainly Congress may permit such claims or exclude them."
>
> *Manhattan Properties* v. *Irving Trust*, 291 U. S. 320, 332.

Section 77B regulates the distribution of the assets of a debtor in the possession of the bankruptcy court. It does not redefine or change the substantive law of landlord and tenant.

The proceeding initiated by this Debtor under Section 77B is merely a continuance of the prior bankruptcy proceeding in which the petition initiating the 77B proceeding was filed and in which this landlord's lease was rejected. The proceeding under Section 77B is "an amplification or new end product of the original bankruptcy, just as though the bankrupt or alleged bankrupt had proposed a composition" (*In re Paramount Publix Corp.; Greenberg* v. *Paramount Pictures, Inc.*, C. C. A., Second Circuit, July 20, 1936, not yet reported).

No constitutional rights of a debtor, or of any of its creditors or stockholders, are invaded by granting the landlord a right to prove a claim for the damages sustained by him as a result of the rejection of his lease in bankruptcy proceedings which were pending when Section 77B was enacted and when the proceedings under Section 77B were initiated.

Since creditors who extended credit after the filing of the petition in bankruptcy enjoy the priority which attaches to all expenses of administration and will therefore be paid in full before any distribution is made to the landlord, such creditors can not be injured by the allowance of the landlord's claim.

The creditors with whom the landlord is permitted to participate on a parity in the distribution of the debtor's assets under Section 77B extended credit before the filing of the petition in bankruptcy and therefore at a time when the landlord's lease was a valid and subsisting obligation of the debtor. Such creditors can not claim that assurances upon which they relied in extending credit have been defeated. As the Court said *In re Inland Dredging Corporation*, 61 F. (2d) 765, 766, "All that was done was to provide for a new division of any pot, which should in the future arise through the sequestration of the debtor's assets in bankruptcy, or any other insolvency proceedings".

In Section 64 of the Bankruptcy Act of 1898 (11 U. S. C. A. § 104), and in all prior bankruptcy Acts, Congress provided certain priorities in the distribution of bankrupt estates. As a result, creditors who have equal rights under applicable state law are relegated to a subordinate position. Frequently, some are paid in full while others receive nothing. They are thus deprived of substantial rights. But since the deprivation is incidental to an exercise of the power over bankrupt estates, there has been no violation of their constitutional rights.

Priorities given under an existing bankruptcy statute may be changed by a subsequent statute, and such a change is effective even as to claims arising prior to the change. *In re Inland Dredging Corporation*, 61 F. (2d) 765; *City of Chelsea* v. *Dolan*, 24 F. (2d) 522.

It seems clear that Congress may permit a landlord, who had a valid and subsisting contract with the Debtor when the court took custody of its assets, to participate with other creditors in the division of such assets for the injury sustained by him through the deprivation of his right to look to the Debtor's assets for the satisfaction of his claims under the lease.

The Debtor had no constitutional right to the use of Section 77B. Congress could have provided that the new procedure be available only to corporations not already in bankruptcy. When it conditioned the use of this procedure upon a recognition of landlords' claims for injuries inflicted in the bankruptcy proceedings, Congress was well within its constitutional power.

If the rights and remedies of all of the parties are actually fixed and crystallized by the bankruptcy proceeding, and such rights and remedies are only those which existed immediately prior to the filing of the petition undr Section 77B, then the use of proceedings under Section 77B by this Debtor is improper and illegal, and any creditor may insist on his right to have the assets of the Debtor liquidated as in bankruptcy in order that he may obtain the cash dividend which he would receive if the bankruptcy proceedings were consummated.

Respectfully submitted,

JOHN GERDES,
JOHN GODFREY SAXE.